

Internal Revenue Service

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Washington, DC 20224

Third Party Communication: None

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PLR-129840-15

Date:

February 29, 2016

X =

Y =

P1

P2

State A =

State B

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Dear

This letter responds to a letter dated October 5, 2015, and subsequent correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X was formed under the laws of State on Date 1 and elected to be treated as an S corporation effective Date 2. On Date 3, X issued shares of its stock to Y, a State B limited liability company taxable as a corporation for federal income tax purposes. Therefore, X's election terminated on Date 3.

On Date 4, X issued shares of its stock to P1, a limited liability company taxable as a partnership for federal income tax purposes. Further, on Date 5, X issued shares of stock to P2, a limited liability company taxable as a partnership for federal income tax purposes. Therefore, X's S corporation election would have terminated on Date 4 and again on Date 5 (if it had not already terminated on Date 3) when X issued shares of its stock to P1 and P2, respectively. On Date 6, X was acquired by a corporation and restructured.

X represents that the issuance of X stock to Y, P1 and P2, ineligible shareholders, was not motivated by tax avoidance or retroactive tax planning. Additionally, X represents that X and its shareholders have filed their federal income tax returns consistent with having a valid S corporation election in effect for X. X and its shareholders have agreed to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

Law

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which a corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under § 1362(d)(2) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the event resulting in the ineffectiveness, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1366(a) generally provides that in determining the tax of an S corporation shareholder, there shall be taken into account the shareholder's pro rata share of the separately and nonseparately stated items of income (including tax-exempt income), loss, deduction, and credit of the S corporation.

Section 1366(d) generally provides that the aggregate amount of losses and deductions taken into account by an S corporation shareholder under § 1366(a) for any taxable year shall not exceed the sum of the shareholder's adjusted bases in the stock and indebtedness of the corporation. Section 1366(d)(2) provides that any loss or deduction which is disallowed under § 1366(d)(1) carries forward indefinitely to succeeding taxable years in which the corporation is an S corporation.

Section 1366(d)(3) provides a special rule for the carryover of suspended losses if a corporation's S election is terminated. Under § 1366(d)(3)(A), if losses have been disallowed in the last taxable year for which a corporation is an S corporation, the losses are "treated as incurred by the shareholder on the last day of any post-termination transition period." Under § 1366(d)(3)(B), the aggregate amount of losses and deductions taken into account under § 1366(d)(3)(A) is limited to the adjusted basis of the shareholder's stock in the corporation determined on the last day of the post-termination transition period. Any losses and deductions in excess of a shareholder's adjusted stock basis are permanently disallowed. Section 1.1366-2(b)(2).

Conclusion

Based solely on the information submitted and the representations made, we conclude that X's S corporation election terminated on Date 3 when shares of X were transferred to Y, an ineligible shareholder. We further conclude that the termination was inadvertent within the meaning of § 1362(f). Moreover, had X's S corporation election not already terminated, it would have terminated on Date 4 and again on Date 5 when

shares of X were transferred to P1 and P2, respectively. Similarly, these terminating events would have been inadvertent terminations within the meaning of § 1362(f).

Accordingly, under § 1362(f), X will be treated as an S corporation from Date 3 until Date 6, when X was restructured, provided that X's S election was valid and was not otherwise terminated under § 1362(d). During the period of Date 3 to Date 6, Y will be treated as a shareholder of X; during the period of Date 4 to Date 6, P1 will be treated as a shareholder of X; and during the period of Date 5 to Date 6, P2 will be treated as a shareholder of X. According, Y, P1, and P2 must include in its income any distributions received from X during the period of ownership, and must include in income its pro rata share of the separately and nonseparately stated items of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368.

Except for the specific ruling above, we express no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether X was otherwise eligible to be treated as an S corporation.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Laura C. Fields

Laura C. Fields
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: